Palan on Piketty

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In late August, 2014, we received an invitation from the NLP to comment on Ronen Palan's 'Capitalising the Future', a piece which, in the editors' opinion, showed some strong affinities with our approach. Our comment was promptly published, but with significant revisions to make the text less confrontational. For those interested, we enclose our original submission below.

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Ronen Palan's piece examines Thomas Piketty's book *Capital in the Twenty-First Century* (2014). The paper indeed shows strong, albeit unmentioned, affinities with our approach. This isn't the first time it has happened, but then old habits die hard. The affinities themselves, though, are largely superficial. Palan demonstrates little understanding of our framework, and we very much doubt he has comprehended Piketty's. His article contains so many elementary errors and fallacies that it is unclear how it got published in the first place.

Piketty's book, Palan argues, is empirically rich and theoretically insightful, but it also leaves important questions unanswered. The book, says Palan, shows that the ownership of capital becomes concentrated because the rate of return on capital far exceeds the pace of economic growth – but it does not explain why the two rates should differ in the first place or what the resulting concentration of wealth 'really amounts to'.

To clarify these latter issues, Palan draws attention to two structural elements which, in his opinion, stand at the heart of modern capitalism: 'futurity' and 'leverage'. Futurity, he contends, explains why the return on capital exceeds the rate of economic growth, while leverage suggests that much of the measured rate of accumulation, particularly by the 'super-rich', is significantly overstated.

Futurity

According to Palan, the gist of Piketty's theory is 'extraordinarily simple': the rate of return on capital r far exceeds the rate of growth of the economy g, and this difference works to concentrate capital in fewer and fewer hands. The basic problem with Piketty's explanation, Palan contends, is that r and g are in fact totally different creatures. In Palan's opinion, the

growth rate *g* belongs to the 'past-oriented' economy, while the rate of return *r* derives from the 'future-oriented' economy. The two economies, he continues, are fundamentally different, and that difference makes the comparison of *g* and *r* 'unfair'. The past-oriented economy, he elaborates, generates 'tangible' assets like real estate, while the future-oriented economy creates 'intangible' ones like human capital. And since, in his view, the former assets are valued based on their replacement cost while the latter are valued based on their future earnings, their comparison is inappropriate.

A professional economist reading Palan's narrative would rightly feel confused. Following Irving Fisher (1896, 1907), the conventional economic creed is that all assets, whether tangible or intangible, are created in the past; and that all assets, whether tangible or intangible, are valued based on the future income they are expected to generate. To connect these two sides of the world, economists assume that, in a perfectly competitive equilibrium, the cost of producing the assets equals their discounted future earnings (Nitzan and Bichler 2009: Ch. 10).

Apparently unaware of this setup, Palan accuses economists of failing to understand his own dichotomy and, consequently, of focusing mainly on past (tangible) assets while neglecting future (intangible) ones. The economists' misunderstanding, he says, explains why the notion of 'High Net-Worth Individuals (HNWI)' is so popular. The term 'net', he informs us, 'refers specifically to [the capitalists'] wealth minus their intangible assets'.

Palan's definition of 'net worth' is certainly novel, and it may well suit the needs of post-economics. But it has nothing to do with the way in which the term is customarily used. In conventional accounting and finance, net worth denotes the difference between total assets and total liabilities, regardless of whether the assets in question are tangible or intangible.

Palan, though, is undeterred. Having illuminated the nature of net worth, he goes on to explain how publicly listed companies like Coca Cola are valued on the market. And here, too, his explanation is eye-opening. This value 'lies somewhere in the future', he says. 'It is calculated on the basis of what is known as the price-to-earnings ratio'.

In our humble opinion, this claim is both tautological and contradictory to its author's own assertions. Begin with the market value of a firm. At any point in time, this value is given by multiplying the number of outstanding shares by the ongoing market price of those shares. But, then, since the market value already contains the company's share price, to say that this value is based on the company's price-to-earnings ratio is to say that this value is based on . . . itself! Moreover, according to Palan, it is future earnings that count for valuation, yet the earnings in the price-to-earnings ratio are those received in the past. . . .

Now, leaving these minor technicalities aside, why is it so important for capitalists in the new age of 'entrepreneurial culture', as Palan calls it, to rely on the future rather than the past? His answer again is enlightening: 'The future dimension adds value to businesses; expected income can be factored into current valuation, which will therefore be above the replacement cost'.

Or will it? Conventional measures of *Tobin's Q*, which calculate the ratio of market value to replacement cost or net worth, oscillate below as well as above 1. This oscillation means

that Palan's 'futurity' can undermine as well as boost capitalist assets. Moreover, in the case of the United States, standard measures put the historical average of *Tobin's Q* since 1900 at *less* than 1; in other words, had Palan bothered to check the conventional data, he would have had to conclude that, on the whole, capitalist 'futurity' had served to *subtract* value from businesses, not add to it.

But then, those who already have their theory are rarely bothered by the facts, so Palan goes on. The effect of capitalizing the future, he states, helps explain not only the short-term collapse and rapid recovery of wealth, but also the long term 'chasm that can open up between "wealth" levels and economic growth' (unlike Piketty, Palan tends to conflate levels with rates of change). This chasm, he claims, opens up because intangible financial assets (which in his view are limited only by 'people's expectations and beliefs' about the future) expand faster than the real economy (which is 'strictly past-oriented and limited to tangible assets'). And it is this chasm between the intangible and tangible, he concludes, that explains why Piketty's rate of return r is far larger than his rate of growth g.

Or does it? First, Palan must surely know that if asset prices were to continuously inflate relative to their replacement cost, the rate of return on those assets r – computed as the ratio of *current* profit to *future*-oriented asset prices – would likely trend downward, bringing it closer and closer to g. Second, Palan must also be aware – from general knowledge or at least from reading Piketty – that roughly two-thirds of modern GDP consists of services; in other words, that the 'tangible' growth rate g is mostly intangible! But then, these are merely economistic nuisances. The important point is to relieve Piketty of his confusions.

Leverage, Palan Style

And here Palan has more to offer. Capitalizing the future, he says, is only one side of the story. The other side is debt. Piketty's r, says Palan, is 'largely determined by a combination of futurity and high leverage'. Capitalists, Palan explains, borrow heavily against their assets (which are already inflated by intangible future hopes), and this leverage, he contends, further – and unduly – inflates their measured 'net' wealth and exaggerates the overall accumulation of capital.

Again, maybe this claim is part of a new meta-theory of postmodern capitalism. The conventional definition of net wealth, though, is assets minus liabilities, so incurring additional debt in order to purchase additional assets makes no difference to a capitalist's *net* position – or to the net position of all capitalists for that matter. This is elementary accounting, and that is why Piketty defines his notion of wealth as the sum of all marketable assets *less* all liabilities. Obviously, soaring leverage per se cannot explain changes in net wealth in general and Piketty's measures in particular.

But Palan is unfazed. 'The upshot of all this', he informs us, 'is that there is considerable ambiguity about the concept of wealth and how to measure it'. Although Piketty's work is 'clearly of great importance, both intellectually and politically', he compliments the celebrated writer, that work isn't enough. 'If we wish to understand how wealth is centralized, con-

centrated and deployed,' he concludes, 'it is important to understand that the category of "wealth" is not as straightforward as conventionally thought'.

But, then, how can we understand this category if we ignore logic, eschew research and disdain the very possibility of truth?

The New Breed

Over the past several decades, universities and the mass media have been invaded by a new breed of academics. Members of this breed have no interest in the pursuit of science and the quest for truth. Instead of reality, they posit an endless multiplicity of 'texts' which they concoct out of thin air and then busily 'deconstruct'. This posture makes them immune to criticism and resistant to refutation. No Sokal-like hoax can deter them from publishing pompous nonsense, from demeaning creativity and dismissing originality, from using the libidinal political economy of continuous mathematics to make 5 equal 2+2.

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